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The following article, published in the *Wall Street Journal* on September 16, 2011, describes the possibility of "Operation Twist" in the latest "unconventional" move by U.S. monetary policy. ("Operation Twist" was a monetary policy move made by the Fed during the Kennedy administration.)

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Federal Reserve Considers Whether to Twist Again

BY **DAVID WESSEL**

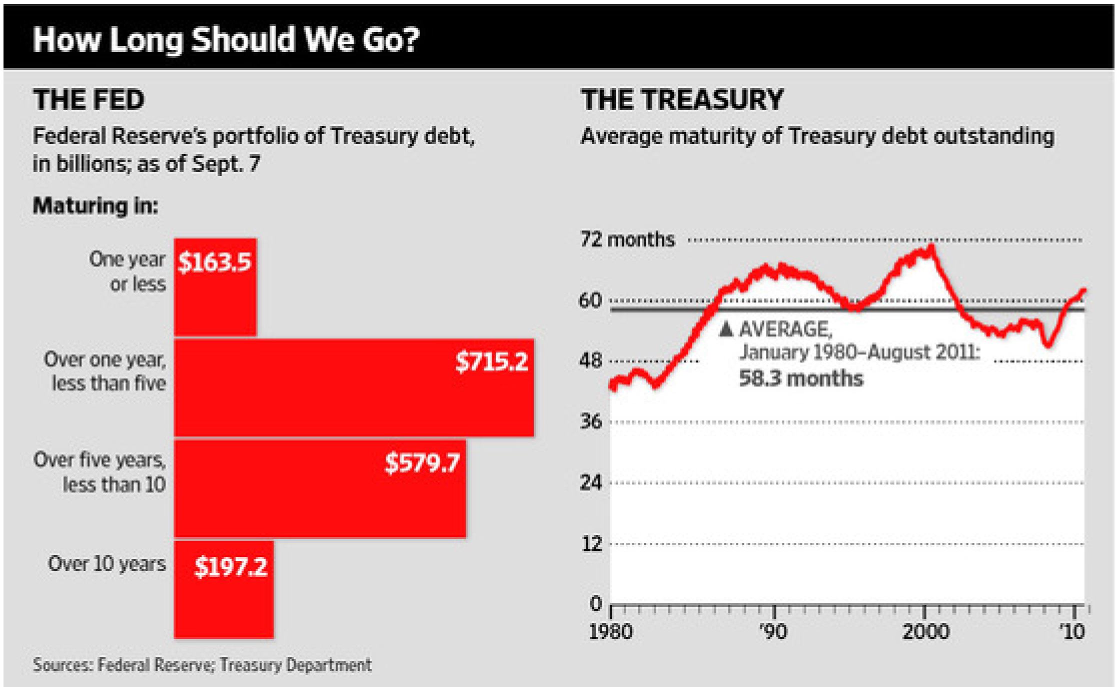
Federal Reserve Chairman Ben Bernanke has demonstrated a straightforward approach to his job: If the Fed forecasts unemployment will be far above normal and inflation is heading below the Fed's target, then the central bank should do something—even if no tool seems potent enough to fix the economy.

In Mr. Bernanke's view, every little bit helps. That's why he's turning to a maneuver pioneered a half-century ago. The central bank is thinking about reshaping its $1.7 trillion portfolio of Treasurys to hold less short-term debt and more long-term, hoping to push already-low long-term interest rates down further.

All this has bond markets and bankers abuzz, though they're easily excited. The yield on 10-year Treasurys, which recently slipped below 2%, suggests traders anticipate the Fed will make the move.

For most folks, though, it's hard to grasp how reshuffling the Fed's portfolio — "rearranging the financial deck chairs," as Washington analyst Douglas Holtz-Eakin put it—can spur growth.

A year ago, the Fed decided to print $600 billion to buy bonds, in the second round of "quantitative easing," or QE2. That was easy to grasp: The more money the Fed pumps into the economy, the more fuel for growth. Except that's not how most at the Fed see it. After all, the Fed put money into the banks, and the banks promptly deposited it at the Fed rather than lending it.



Rather, the Fed figures that QE2 worked largely by taking a lot of two-year to seven-year Treasury debt out of the market, chasing investors into other assets: longer-term Treasurys (pushing down their yields and making borrowing cheaper for home buyers and companies), stocks (making everyone feel wealthier so they would spend more) and so on. It also worked by lowering the dollar's value against other currencies, but that's another story.

Fed economists figure QE2 shaved about two-tenths of a percentage point off long-term rates, the ones important to mortgages and corporate borrowing.

Today the Fed holds more than $500 billion in Treasurys that mature in less than three years, and less than $200 billion in Treasurys that mature in less than 10 years. If it sold, say, $300 billion of short-term debt to buy longer-term debt, the thinking goes, it could push long-term rates about two-tenths of a percentage point below where they'd otherwise be.

This echoes a 1961 attempt by the Kennedy administration to keep short-term rates stable or rising (to help the dollar) while lowering long-term rates (to help the economy). The effort was known as "Operation Twist," after the popular dance step. (Finally, a monetary-policy story with a soundtrack.)

In 2004, Mr. Bernanke (then a Fed governor) and Fed staffers Vincent Reinhart (now at Morgan Stanley) and Brian Sack (now running the New York Federal Reserve Bank market desk) wrote, "Operation Twist is widely viewed as a failure." They noted that Nobel laureate Franco Modigliani described the impact as "moderate at best," estimating it cut long-term rates by 0.1 or 0.2 percentage point. Times have changed. A recent re-examination by a San Francisco Fed economist is cited as proof that Twist was a success, even though it, too, found that rates were reduced by only 0.15 percentage point.

Any move by the Fed to pull long-term bonds away from investors' hands (driving down the yield) would be diluted if the Treasury sold more of them. "The Fed would need to coordinate with the Treasury," Mr. Bernanke wrote in 2004, "to ensure Treasury debt-issuance policies did not offset the Fed's actions."

Lately the Treasury has been selling more long-term bonds, reasoning that taxpayers benefit by locking in historically low rates and reducing risks that the U.S. might have trouble rolling over short-term debt some day. The average maturity of Treasury debt has stretched to 62 months, above the 30-year average. Treasury's bond-market advisers want to lengthen it further.

The Fed and Treasury are talking, but each says it has its own job to do. "The Fed is worried that we might turn into Japan while the Treasury wants to make sure that we don't turn into Greece," research firm Wrightson ICAP wrote recently. One possible outcome: The Treasury will stop lengthening the debt maturity, but, unlike in the 1960s, it won't explicitly link the decision to anything the Fed is doing.

Operation Twist 2.0 won't by itself rejuvenate the economy. If combined with other measures, it could help, especially if it renews public and business confidence.

But there is—forgive me—a twist. The move appeals to the Fed as a compromise because some officials are uneasy about launching QE3—printing more money and expanding the Fed portfolio. But if rearranging instead of expanding the Fed portfolio seems inconsequential to the public, its impact on the economy might be limited.

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